



How Italian Colors Guts Private Antitrust Enforcement by Replacing It With Ineffective Forms Of Arbitration

Citation

Einer Elhauge, How Italian Colors Guts Private Antitrust Enforcement by Replacing It With Ineffective Forms Of Arbitration, 38 Fordham Int'l L. J. 771 (2015).

Published Version

http://fordhamilj.org/files/2015/05/FILJ_Elhauge_HowItalianColorsGutsPrivateAntitrustEnforcement.pdf; <http://fordhamilj.org/articles/how-italian-colors-guts-private-antitrust-enforcement-by-replacing-it-with-ineffective-forms-of-arbitration/>

Permanent link

<http://nrs.harvard.edu/urn-3:HUL.InstRepos:16073957>

Terms of Use

This article was downloaded from Harvard University's DASH repository, and is made available under the terms and conditions applicable to Open Access Policy Articles, as set forth at <http://nrs.harvard.edu/urn-3:HUL.InstRepos:dash.current.terms-of-use#OAP>

Share Your Story

The Harvard community has made this article openly available.
Please share how this access benefits you. [Submit a story](#).

[Accessibility](#)

ISSN 1936-5349 (print)
ISSN 1936-5357 (online)

HARVARD

JOHN M. OLIN CENTER FOR LAW, ECONOMICS, AND BUSINESS

HOW *ITALIAN COLORS* GUTS PRIVATE ANTITRUST ENFORCEMENT BY REPLACING IT WITH INEFFECTIVE FORMS OF ARBITRATION

Einer Elhauge

Forthcoming in *Fordham International Law Journal*

Discussion Paper No. 824

04/2015

Harvard Law School
Cambridge, MA 02138

This paper can be downloaded without charge from:

The Harvard John M. Olin Discussion Paper Series:
http://www.law.harvard.edu/programs/olin_center/

The Social Science Research Network Electronic Paper Collection:
<http://ssrn.com/abstract=2559386>

HOW *ITALIAN COLORS* GUTS PRIVATE ANTITRUST ENFORCEMENT BY REPLACING IT WITH INEFFECTIVE FORMS OF ARBITRATION

Einer Elhauge
Petrie Professor of Law, Harvard Law School

10/16/2014. Forthcoming 38 Fordham International Law Journal

America is becoming more like Europe, and not in a good way. For a long time, the central difference between antitrust enforcement in the United States and Europe has been that the United States features not only public enforcement, but a vigorous system of private antitrust enforcement, while in Europe, public agencies have had an effective monopoly on antitrust enforcement. But that difference is on the verge of collapsing. We are achieving a form of convergence. But contrary to expectations, this convergence is not coming from reforms to make private enforcement more effective in Europe, which have not yet overcome some serious obstacles on discovery and class actions. Instead, it is coming from the recent US Supreme Court decision in *American Express v. Italian Colors Restaurant*,¹ which threatens to gut private antitrust enforcement in the United States by replacing it with ineffective forms of arbitration.

¹ 570 U.S. ___, 133 S.Ct. 2304 (2013).

Procedural differences explain the prior divergence between the United States and Europe on private antitrust enforcement. After all, private claims for violations of European competition law can and have been brought, so it is not as if European law bans private antitrust suits. However, limited discovery and the lack of class-action suits have generally meant that private suits are usually infeasible in Europe. Nowadays, you generally cannot prove antitrust damages without proving market definition, market power, and the economic effects of the conduct. Proving those elements requires market data and economic experts to analyze it. But without discovery, a private plaintiff cannot obtain the necessary data, and without class action mechanisms, a disperse group of market participants cannot fund the expensive expert reports necessary to analyze it. Thus, in Europe, the field of antitrust enforcement has largely been left to public enforcers. The new EU directive on antitrust damages encourages European nations to provide more private discovery and to allow at least opt-in class actions, but does not yet mandate clear rules to solve these problems.

Historically matters have been quite different in the United States, which also effectively requires market data and economic experts to prove antitrust damages, but instead allows liberal discovery to collect that market data and class actions to fund the economic experts. Or at least that was the law before the Supreme Court's decision in *Italian Colors*. In that case, the Supreme Court

considered “whether a contractual waiver of class arbitration is enforceable under the Federal Arbitration Act when the plaintiff’s cost of individually arbitrating a federal statutory claim exceeds the potential recovery.”² The decision recognized that “the cost of an expert analysis necessary to prove the antitrust claims would be ‘at least several hundred thousand dollars, and might exceed \$1 million,’ while the maximum recovery for an individual plaintiff would be \$12,850, or \$38,549 when trebled.”³ As Justice Kagan observed in dissent, “No rational actor would bring a claim worth tens of thousands of dollars if doing so meant incurring costs in the hundreds of thousands.”⁴ Accordingly, Justice Kagan and the Second Circuit concluded, the contract provision waiving class arbitration fell afoul of the rule that arbitration provisions should not be enforced when they prevent the “effective vindication” of federal law.⁵

How, then, did the Supreme Court majority justify its conclusion that the effective vindication of antitrust law was not thwarted by a provision that required plaintiffs to proceed in an individual way that meant costs would be at least 10 times the possible recovery if the plaintiff won? Its analysis boiled down to one thin paragraph, with two thinner reasons.

² 133 S.Ct. at 2307.

³ *Id.* at 2308.

⁴ *Id.* at 2316 (Kagan, J, dissenting).

⁵ *Id.* at 2313-2320 (Kagan, J, dissenting); *In re American Express Merchants' Litigation*, 554 F.3d 300, 315–316 (2d Cir. 2009).

First, in an effort to distinguish prior cases holding that arbitration clauses could neither waive a party's right to pursue statutory remedies nor impose arbitration fees that were too large to make access practicable, the Supreme Court argued that those cases involved the ability or expense necessary to "*pursue*" the statutory remedy, rather than "the expense involved in *proving* a statutory remedy".⁶ As the dissent pointed out, this amounted to simply saying that the prior cases involved different facts; the whole point of having a principle like "effective vindication" is that enforceability can be gutted in a myriad of ways, so we need a general principle to deal with all the variations.⁷ More fundamentally, there simply is no meaningful difference between the right to pursue a claim and the right to prove it, given that pursuing a claim necessarily requires proving it to win. It is rather like saying you have the right to be represented at trial by counsel, as long as your counsel does not speak.

Second, the Supreme Court reasoned that the 1890 and 1914 Congresses that enacted the Sherman and Clayton Acts could not possibly have thought that class action procedure was necessary to effectively indicate federal antitrust rights because those Acts were enacted decades before federal class actions were made possible by Federal Rule of Civil Procedure 23.⁸ But the Court failed to grapple

⁶ *Id.* at 2310-11 (emphasis in original).

⁷ *Id.* at 2317-18 (Kagan, J, dissenting).

⁸ *Id.*, at 2311.

with the simple fact that back then plaintiffs could and usually did prove antitrust violations and damages without any economic rigor and thus did not need an economics expert. That made individual low-stakes antitrust suits far more possible. Now that the courts have interpreted federal antitrust law to require an economically rigorous showing on market definition, power, and effects, antitrust claims require an economics expert, precluding individual low-stakes suits and thus requiring some sort of class procedure to share the costs.

The Court conceded that “the effective-vindication rule asks about the world today, not the world as it might have looked when Congress passed a given statute”, but the Court reasoned that “time does not change the meaning of effectiveness, making ineffective vindication today what was effective vindication in the past.”⁹ However, this reasoning is simply not responsive because the point is that changes in the world require economic expert testimony to prove a claim now but not then. This change demonstrates that under a *constant* meaning of effectiveness, a procedure that does not allow expert testimony makes vindication ineffective now, even though it would not have made it ineffective back then when no expert testimony was required to prove a claim. To put it another way, the Congress that enacted the Sherman and Clayton Acts intended to create a right of private antitrust enforcement. That Congress might have thought that right would

⁹ *Id.* at 2311 n.4.

be vindicated without class actions back when little proof was required, and that Congress might have thought that right could be vindicated when the courts required additional expensive proof as long as class procedures allowed that proof to be funded. But that Congress could not have thought that right would be vindicated if the courts both required additional expensive proof and disallowed any class procedures necessary to fund it.

Justice Thomas' concurring opinion actually offered a more coherent rationale: that plaintiff's voluntary consent to the arbitration provision required enforcing that provision even it waived effective or even literal enforcement of a statutory right.¹⁰ This consent rationale raises an important challenge that I think helps explain the sort of instinct that led the Court to be so unconcerned with whether or not it was really preserving effective vindication. After all, if customers voluntarily consent to an arbitration provision that guts an enforcement right, cannot we conclude that those customers must have thought that the enforcement right was worth less than whatever they got in return in the contract negotiation? Would not preventing enforcement of such provisions thus make customers worse off?

To address this challenge, it is best to begin by asking ourselves a foundational question: why do we have antitrust laws at all? After all, virtually all

¹⁰ *Id.* at 2312-13 (Thomas, J, concurring).

antitrust violations require the consent of the defendant's customers. If defendants enter into a cartel or merger that raises prices, buyers could in theory defeat it by refusing to pay any increase in prices. The cartel or merger works only because buyers instead consent to those prices. If a monopolist uses predatory pricing, tying, exclusive dealing, or other exclusionary conduct to exclude its rivals and raise prices to consumers, those consumers could in theory defeat the conduct by refusing to accept the predatorily-priced good, the tying condition, or any other exclusive or exclusionary condition. Exclusionary conduct works only if buyers consent to it. Thus, the consent logic wrongly implies that all antitrust violations must benefit the buyers who agree to them, precisely contrary to purpose of antitrust law, which is to protect consumer welfare.

The flaw in this consent logic is that buyers in markets have a collective action problem. If buyers acted together, then they would refuse to consent to conduct that harms them all. But acting individually, each buyer has incentives to agree to inflated prices or exclusionary conditions because they know that in a market with many buyers, no individual buyer's refusal to consent will affect the market result, but an individual refusal to consent will affect whether that buyer

gets the good it desires.¹¹ The whole reason we have antitrust laws is to provide a collective action solution, via statute, to our collective action problem.

The same problem infects consents to arbitration clauses that waive the right to effective vindication of antitrust law. If buyers acted together, then they would only consent if those waivers made them better off. But acting individually, each buyer has incentives to consent in exchange for a trivial discount from the inflated marketwide prices that will result when all buyers consent to effectively immunizing antitrust violations against them. It takes only a trivial discount because each buyer knows that its individual decision whether to consent has little effect on whether the marketwide harm from immunizing antitrust violations occurs.

To put it another way, competitive markets are a public good, from which each buyer in a market benefits, whether or not that buyer contributes to the creation of that public good by rejecting conduct or agreements that keep that market competitive. Thus, buyers inevitably have incentives not to contribute; instead they will predictably consent to conduct and arbitration waivers that result in uncompetitive markets.

¹¹ See, e.g., Einer Elhauge, *Tying, Bundled Discounts, and the Death of the Single Monopoly Profit Theory*, 123 Harv. L. Rev. 397, 456-457 (2009) (detailing this issue for the sort of tying claim considered in the *Italian Colors* case); Elhauge, *Defining Better Monopolization Standards*, 56 STANFORD LAW REVIEW 253, 284-28 (2003) (detailing it for other exclusionary conduct).

The future implications are alarming. Given the *Italian Colors* decision, it is hard to see why all businesses would not at least insert arbitration clauses into their contracts that preclude class arbitration. Indeed, 90% of financial agreements already have arbitration clauses that preclude consumer class actions.¹² Given the limited nature of discovery in arbitration, that alone will bring US private enforcement largely into convergence with Europe, and perhaps will leave US private enforcement even less effective than the EU in the future if the new EU directive leads to stronger national rules on discovery and class actions.

But businesses are likely to go even further given the Supreme Court's logic that arbitration provisions are permissible whenever they eliminate only the right to *prove* a claim, rather than the right to *pursue* it. Under this logic, parties could adopt arbitration provisions eliminating the ability to introduce economic expert testimony altogether, even though that would effectively preclude not only class suits but also suits by corporate plaintiffs that might have large enough stakes to fund an expert. The Court's offered two responses to this possibility. First, it said "it is not a given that such a clause would constitute an impermissible waiver,"¹³ which alarmingly suggests it might well be deemed enforceable. Second, it said that this possibility would be different because "such a clause, assuming it makes

¹² See <http://www.cfpbmonitor.com/2014/04/09/cfpb-and-ftc-representatives-speak-at-symposium-on-fine-print/>

¹³ *Id.* at 2311 n.3.

vindication of the claim impossible, makes it impossible not just as a class action but even as an individual claim.”¹⁴ But that rationale conflicts with the Court’s logic that the difference is between being able to pursue a claim and prove it. It thus, disturbingly, suggests that the Court’s real rationale is a hostility to class actions over corporate suits, rather than a neutral reading of the arbitration statute.

Moreover, the Court’s logic would also seem to permit many other possible ways of gutting antitrust enforcement that the Court did not address. Parties could adopt provisions that preclude discovery even more than it is already limited in arbitration, say by barring any discovery into market definition, power, or anticompetitive effects. Indeed, the Court’s distinction between barring proof versus barring pursuit of a claim would even suggest that arbitration clauses could baldly prohibit offering any *proof* in arbitration on market definition, power, or anticompetitive effects, because that would go simply to the right to prove the claim. This would leave private enforcement by US buyers even less effective than in Europe.

This development would immunize businesses against US federal antitrust enforcement by anyone who contracts with them, which is almost any private party who can sue given that federal antitrust law largely limits antitrust enforcement to direct purchasers. The main exception would be antitrust suits by rivals excluded

¹⁴ *Id.*

by exclusionary conduct, who may have no contract with the defendant and thus no arbitration provision. But that is hardly an adequate substitute because “any rival claim will be limited to the competitive profits the rival could have earned on some share of the market in the but-for world. A monopolist will generally find it profitable to pay such low competitive profits on a smaller market share out of the monopoly profits it gains on its monopoly market share.”¹⁵ Further, “it is too easy to cut side deals with rivals through settlements that may satisfy the financial interests of the rivals but fail to fix (or even worsen) the anticompetitive problem.”¹⁶ Indeed, the *Italian Colors* decision creates incentives for them to cut side deals that include arbitration provisions that bar effective antitrust enforcement between them. And given that the *Italian Colors* allows each business to use arbitration clauses that effectively immunize them against their buyers, businesses might not have much incentive to even try to exclude each other since it is more profitable to instead collude and jointly exploit their buyers.

Michael Blechman’s thoughtful paper in this conference offers various ways an arbitrator might resist the unjust effects of *Italian Colors*. His paper convinces me that he would be a terrific and creative arbitrator. But I don’t think this resistance would be effective.

¹⁵ Elhauge, *Disgorgement as an Antitrust Remedy*, 76 ANTITRUST LAW JOURNAL 79, 85 (2009).

¹⁶ *Id.*

First, just as a factual clarification, my thesis does not depend upon any assumption that expert opinions would necessarily cost a million dollars. It depends only on the Court's own conclusion that it did not matter whether the litigation was economically feasible without class arbitration because all you have is the right to pursue a claim, not to prove it. The Court's conclusion makes it okay to refuse to allow class arbitration, even if though that is effectively preclusive whenever expert fees exceed individual stakes at all. That is so even on the charitable assumption that parties know that it is 100 percent likely that they are going to win, which is in fact implausible. The notion that expert fees exceed individual stakes seems likely true in most mass-market cases, and certainly in *Italian Colors*, where the highest individual stake was \$38,000. If you can get an economics expert to give you a complex report for \$38,000, I suspect you will get a quality as low as the fee that you are paying.

Now, Michael argues that arbitrators could change the rules to lower the costs of proving a claim — for example, by lowering the standards for defining a market. I actually doubt that they could do that. I think an arbitrator who did so would be vulnerable to the finding that they have willfully disregarded the law if they found an illegal tie, for example, without reliable economic proof of tying market power. But even if they could do so, do we really want arbitration

decisions based upon loosey-goosey assertions of market power and proof of effects? I think that cure may actually be even worse than the disease.

But let's assume Michael is right about that. The more important point to me is that *Italian Colors* holds that arbitration provisions do not have to make litigation economically feasible. So why on Earth would they? Corporations actually have every incentive to, instead, write their arbitration agreements to choose arbitration systems that do not try to lower costs, or that even specify that arbitrators cannot do so. In short, given the logic of *Italian Colors*, there is nothing to stop businesses from immunizing themselves from private litigation, other than a failure of will or imagination.

Now, Michael also notes that the *Italian Colors* Court's opinion in footnote 4 denied that the arbitration provision at issue there necessarily prohibited other forms of cost-sharing. But the Court's opinion also accepted in that same footnote the premise that those other forms of permissible cost-sharing, if they existed, were economically unfeasible, and said that that unfeasibility simply did not matter. So the Court was not relying on the feasibility of some alternative method of cost-sharing for his holding. The Court held it simply did not matter because the inability to prove a claim was not a problem. So a corporation that chose an arbitration provision that provides no economically feasible alternative method of funding would face no difficulty in getting enforced under this opinion.

Michael also notes that on remand the *Italian Colors* plaintiffs argued that they could at least still pursue class action injunctive relief, an issue not really resolved since they settled. But again, the trouble is that, under *Italian Colors*, future arbitration provisions could simply explicitly prohibit class injunctive relief, and that would be enforceable under the Court's opinion. So there is every reason to think that businesses would take advantage of that.

Michael also suggests that an arbitration contract that denied effective antitrust enforcement would be unconscionable as a matter of contract law. Putting on my contract law professor hat, I think not. First, the reality is that this opinion allowed precisely that form of contract. So, obviously, the Court did not think that it was unconscionable or unenforceable. Second, under contract law, unconscionability requires both procedural unconscionability and substantive unconscionability. Procedural unconscionability requires some unfair surprise, which will not be present as long as the arbitration provision is clear and salient. Substantive unconscionability requires an unequal bargain. But there really isn't one here, because the individual buyer's right to pursue an antitrust claim against a market-wide harm really is not worth much on an individual basis. So they are individually fairly compensated by a trivial discount in the contract. The problem is that such agreements undermine the enforcement of rights to competition whose value is collective rather than individual.

Finally, Michael suggests that effective enforcement is not denied because private parties can — and the *Italian Colors* plaintiffs in fact did — also give their information to the government to pursue public claims. But if that is really the only option we can count on in the future, to me that simply establishes my thesis, which is that this opinion threatens to change the U.S. regime into a one that relies only on public enforcement and largely abandons private enforcement.